

Letter of Findings: 04-20130353
Sales and Use Tax
For the Years 2010, 2011, and 2012

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ISSUE

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-11](#); [45 IAC 2.2-5-12](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Rhoads v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974) Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); Mynsberge v. Indiana Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Mumba Bros. Drilling Co. v. Indiana Dep't of State Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); General Motors Corp. v. Indiana Dep't. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Sales Tax Information Bulletin 60 (July 2006); Sales Tax Information Bulletin 60 (April 2011).

Taxpayer protests the assessment of sales/use tax on purchases of tangible personal property.

STATEMENT OF FACTS

Taxpayer, an Indiana company, is a construction contractor. Taxpayer also manufactures hot mix asphalt materials to be used in the construction of roads, parking lots, and driveways. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit for tax years 2010, 2011, and 2012. Pursuant to the audit, the Department determined that Taxpayer did not pay sales tax or self-assess use tax on certain purchases of tangible personal property used in performing construction contracts, including repair parts for construction equipment, a front-end loader, backhoes, dozers, rollers, calcium trucks/distributors and service trucks off-road diesel fuel, software subscriptions with upgrades, and magazine subscriptions. The Department also determined that Taxpayer did not pay sales tax or self-assess use tax on certain purchases of tangible personal property used at its asphalt plant. As a result, the Department's audit assessed additional use tax and interest. The Department, nonetheless, waived the negligence penalty.

Taxpayer protested the assessment for the following purchases: (1) precast concrete blocks, (2) Cat. 950H and 950F loaders, (3) Cat. CB 24 and DD-90 rollers, and (4) shelters ("Items at Issue"). A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition.

DISCUSSION

The Department's audit determined that Taxpayer did not pay sales tax or self-assess use tax on certain purchases, which it used at its asphalt plant.

Taxpayer, to the contrary, argued that sales/use tax was not due because it was entitled to the manufacturing exemption on the purchases of the Items at Issue pursuant to IC §§ 6-2.5-5-3(b) and 6-2.5-5-5.1(b). In its September 12, 2013, protest letter, Taxpayer explained, in relevant part, as follows:

1. The purchase of precast concrete blocks should be exempt because these blocks were used as the foundation for a shelter that has been determined to be a part of the plant and as such exempt from sales tax. These blocks are a different size than other blocks that were used as the foundations of other shelters determined to be taxable so these particular blocks are known to be part of the exempt shelter. . . .
2. The Cat. 950H & 950F loaders should be exempt because these loaders are dedicated to the charging of the plant with materials. They are used to sort, mix and distribute all materials and as such alter the natural state of the materials. This procedure is one of the steps in the manufacture of asphaltic concrete. As a step in the production cycle the purchase of parts and fuel for these pieces of equipment should be exempt. They are not used for any other purposes. . . .
3. The Cat. CB-24 roller and DD-90 roller should be exempt because these rollers are the final step in the production process. For this reason these pieces of equipment, along with their fuel and repair parts, should be exempt. . . .
4. All shelters should be exempt. The processing of RAP (crushing and screening) is the start of the production process for asphalt using RAP in its mix design. These shelters are used to protect the RAP from moisture after it has been processed for use. . . .

As a threshold issue, all tax assessments are prima facie evidence that the Department's assessment of tax is presumed correct. "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoades v. Indiana Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. Rhoades, 774 N.E.2d at 1048; USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466, 468 – 69 (Ind. Tax. Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. USAir, Inc., 623 N.E.2d at 468 – 69. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b) and (c); IC § 6-2.5-3-2(a).

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. 45 IAC 2.2-5-8(a). A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 101 (quoting Conklin v. Town of Cambridge City (1877), 58 Ind. 130, 133). Thus, in applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). The exemptions to which Taxpayer aspires like all tax exemption provisions, is strictly construed against exemption from the tax. Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); Mynsberge v. Indiana Dep't of State Revenue, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999).

IC § 6-2.5-5-3(b), in relevant part, provides:

[T]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it **for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.** (Emphasis added).

IC § 6-2.5-5-5.1(b), in relevant part, provides:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it **for direct consumption as a material to be consumed in the direct production of other tangible personal property** in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture.

(Emphasis added).

Thus, the Legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture . . . of other tangible personal property." In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. "Fairly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." Mumma Bros. Drilling Co. v. Indiana Dep't of State Revenue, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520, 525 (Ind. 1983). "The test for directness requires the equipment to have an 'immediate link with the product being produced.'" Id. (Quoting Department of Revenue v. U. S. Steel Corp., 425 N.E.2d 659 (Ind. App. Ct. 1981)). Accordingly, the sales tax exemption is applicable to that equipment which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. General Motors Corp. v. Indiana Dep't. of State Revenue, 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991). The application of Indiana's double-direct manufacturing exemptions varies based on a determination of when a taxpayer's manufacturing process is considered to have begun and ended.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in

direct production. [45 IAC 2.2-5-8\(a\)](#). Machinery, tools, and equipment are directly used in the direct production process if they have an immediate effect on the article being produced. [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. Id. An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#), Example (1). However, "[e]quipment used to remove raw materials from storage prior to introduction into the production process or to move finished products from the last step of production" is not exempt because the use of the equipment lacks "an essential and integral relationship with the integrated production system." [45 IAC 2.2-5-8\(c\)](#), Example (4)(G).

[45 IAC 2.2-5-8\(k\)](#) describes direct production as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired. The change must be substantial resulting in a transformation of the property into a different and distinct product.

The exemption for direct use in production is further explained at [45 IAC 2.2-5-11](#), in part, as follows:

(a) The state gross retail tax shall not apply to sales of tangible personal property to be directly used by the purchaser in the direct production or manufacture of any manufacturing or agricultural machinery, tools, and equipment described in [IC 6-2.5-5-2](#) or 6-2.5-5-3 [[IC 6-2.5-5-3](#)].

(b) The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to tangible personal property directly used in the direct production of manufacturing or agricultural machinery, tools, and equipment to be used by such manufacturer or producer.

(c) The state gross retail tax shall not apply to purchases of tangible personal property to be directly used by the purchaser in the production or manufacturing process of any manufacturing or agricultural machinery, tools, or equipment, provided that the machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect upon the article being produced or manufactured. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

(d) For the application of the rules [subsections] above, refer to Regs. 6-2.5-5-3 [[45 IAC 2.2-5-8](#) through [45 IAC 2.2-5-10](#)] ([45 IAC 2.2-5-9](#)) with respect to tangible personal property used directly in the following activities: pre-production and post-production activities; storage; transportation; tangible personal property which has an immediate effect upon the article produced; maintenance and replacement; testing and inspection; and managerial, sales, and other nonoperational activities.

The exemption for direct consumption in production is further explained at [45 IAC 2.2-5-12](#), in part, as follows:

(a) The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.

(b) The exemption provided by this regulation [[45 IAC 2.2](#)] applies only to tangible personal property to be directly consumed in direct production by manufacturing, processing, refining, or mining. It does not apply to machinery, tools, and equipment used in direct production or to materials incorporated into the tangible personal property produced.

(c) The state gross retail tax does not apply to purchases of materials to be directly consumed in the production process or in mining, provided that such materials are directly used in the production process; i.e., **they have an immediate effect on the article being produced. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.**

(**Emphasis added**).

[45 IAC 2.2-5-8\(d\)](#) states:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

[45 IAC 2.2-5-8\(e\)](#) states:

Storage equipment. Tangible personal property **used in or for the purpose of storing raw materials or finished goods is subject to tax** except for temporary storage equipment necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another.

(**Emphasis added**).

[45 IAC 2.2-5-8\(f\)](#) provides:

Storage equipment.

(1) Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable.

(2) Tangible personal property used for moving finished goods from the plant after manufacture is subject to tax.

(3) Transportation equipment used to transport work-in-process or semi-finished materials to or from

storage is not subject to tax if the transportation is within the production process.

(4) Transportation equipment used to transport work-in-process, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process.

[45 IAC 2.2-5-8](#)(g) further states:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit.

The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

(Emphasis added).

Additionally, [45 IAC 2.2-5-8](#)(j) provides:

Managerial, sales, and other non-operational activities. Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax. This category includes, but is not limited to, tangible personal property used in any of the following activities: management and administration; selling and marketing; exhibition of manufactured or processed products; safety or fire prevention equipment which does not have an immediate effect on the product; space heating; ventilation and cooling for general temperature control; illumination; heating equipment for general temperature control; and shipping and loading.

The Department's Sales Tax Information Bulletin 60 (July 2006), 20060823 Ind. Reg. 045060287NRA and Sales Tax Information Bulletin 60 (April 2011), 20110427 Ind. Reg. 045110247NRA ("Information Bulletin 60") further explain, in relevant part, as follows:

ASPHALT MANUFACTURERS

Asphalt manufacturers are entitled to a manufacturing exemption for sales and use taxes (under Indiana Code [IC 6-2.5-5](#)) for the asphalt plant and pavers, including repair parts and fuel for the respective equipment. Asphalt manufacturers are granted an exemption from sales and use taxes for dump trucks used to transport "hot mix asphalt" from their asphalt plant to the job site.

No exemption from sales and use tax is available to the extent that the respective dump trucks are ever used to haul "raw materials."

No exemption from sales and use tax is available for dump trucks if the construction contractors do not produce "hot mix asphalt."

No exemption from sales and use tax is available for graders, rollers, distributors, front-end loaders, and other construction equipment.

Actual records must be maintained to document the exempt usage, if any.

(Emphasis added).

Taxpayer, in this instance, stated that it "is in the business of manufacturing hot mix asphalt materials for public and private uses in roads, parking lots, etc. The raw material used are stone aggregates, asphalt oils, recycled asphalt pavements (RAP), and recycled asphalt shingles." Taxpayer further claimed that its "manufacturing process begins when [raw] materials are trucked in and dumped on our site in stockpile areas. The needed materials are various sizes [and] are combined according to design formulas for various asphalt mixtures." Taxpayer thus argued that its purchases of the Items at Issue were exempt from sales/use tax. To support its protest, Taxpayer submitted additional documentation, including photos and video clips, to demonstrate its use of its stockpiles, loaders, and shelters.

Upon reviewing Taxpayer's documentation, however, the Department is not able to agree. First, the Department's Information Bulletin 60 explains that the asphalt manufacturers are not entitled to the manufacturing exemption concerning the rollers. Also, Taxpayer did not provide any supporting documentation regarding its use of the Cat. CB 24 and DD-90 rollers. Thus, Taxpayer's protest of the rollers at issue is denied.

Additionally, the Department is not able to agree that Taxpayer's "manufacturing process begins when [raw] materials are trucked in and dumped on our site in stockpile areas." As mentioned above, in order to be exempt from sales/use tax, items are required to be directly used in direct production, "i.e., they have an immediate effect on the article being produced." [45 IAC 2.2-5-8](#)(d) further explains, "'Direct use in the production process' begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form." Thus, Taxpayer's asphalt production begins, after the raw materials are "ready to be proportioned for entry to the mixing plant," and ends when the asphalt mixture is formed.

In this instance, Taxpayer's documentation demonstrated that it used the loaders to move the raw materials (stockpiles) at its asphalt plant, including stone aggregates, recycled asphalt pavements, and recycled asphalt shingles, which were raw materials delivered, "loaded, trucked, and dumped" at its asphalt plant. Thus, pursuant

to [45 IAC 2.2-5-8](#)(c), Example (4)(G), and the Information Bulletin 60, Taxpayer's use of the loaders – to move its raw materials – is pre-production and is not exempt.

Similarly, Taxpayer's documentation demonstrated that it purchased precast concrete blocks to build shelters, which were used to store the raw materials. Thus, pursuant to [45 IAC 2.2-5-8](#)(c), Example (4)(G), and the Information Bulletin 60, its use of the precast concrete blocks and shelters is pre-production and is not exempt.

In short, given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer met its burden of proof demonstrating that it was entitled to the manufacturing exemption for the purchases in question. Since Taxpayer did not pay sales tax at the time of its purchases, use tax is properly imposed.

FINDING

Taxpayer's protest is respectfully denied.

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